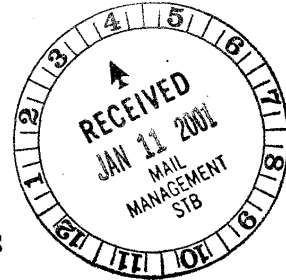


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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES



UNION PACIFIC'S CLOSING COMMENTS

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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

UNION PACIFIC'S CLOSING COMMENTS

Union Pacific Railroad Company ("UP") offers these closing comments to respond to certain comments submitted in the reply filings on December 18, 2000. In addition to responding to certain comments, UP takes this opportunity to compile and consolidate its recommendations for each of the rules proposed by the Board. UP has made numerous specific proposals and suggested draft language for many provisions of the merger rules. We gather those recommendations here, organized in the order of the Board's proposed rules as set forth in the Board's Notice of Proposed Rulemaking served Oct. 3, 2000 ("NOPR"). We include a brief explanation of UP's reasons for each proposed change, with references to the pertinent pages of UP's prior comments. We also note instances where we revised our recommendations in response to reply comments. We hope this compilation will prove useful.¹

¹ The notation "no changes" will appear when UP suggests no modifications or substitutions to the proposed rules. When UP quotes language of an existing proposed rule, UP's suggested additional text will be underscored and UP's proposed deletions will be indicated by empty brackets "[]". When UP proposes that an entirely new section be added,

(continued ...)

UP also joins in the comments filed today by the Association of American Railroads (“AAR”) and the National Railway Labor Conference.

Proposed § 1180.1(a): General.

No changes. UP believes that the Board’s revised general policy statement appropriately modifies its merger policy to reflect structural changes in the rail industry over the last two decades.

Proposed § 1180.1(b): Consolidation criteria.

No changes.

Proposed § 1180.1(c): Public interest considerations.

UP subscribes to AAR’s comments. As AAR points out, this provision contains a number of unwarranted presumptions and requires non-remedial “enhanced competition.” UP disagrees with this approach, believing that the Board can and should prescribe conditions to remedy all significant competitive harms and therefore should not go further. While the Board should treat enhanced competition as a public benefit, it should not demand enhanced competition unconnected to the effects of the merger.

UP recommends that the Board delete all of this section except the first, last, and penultimate sentences.

Proposed § 1180.1(c)(1): Potential benefits.

UP believes the Board should clarify that only benefits that require merger

(... footnote cont'd)

the proposed text of that section will appear (not underscored) with the appropriate section number.

should be considered public benefits of a proposed merger.² UP suggests that the Board add a sentence following the second to last sentence of proposed § 1180.1(c)(1) as follows:

Applicants shall make a good faith effort to calculate the net public benefits their merger will generate, and the Board will carefully evaluate such evidence. Only benefits that cannot reasonably be achieved by means short of merger will be deemed benefits of the merger.

UP also believes that the Board should modify its rules to recognize that circumstances change, and that, accordingly, applicants should not be required to achieve every benefit proposed in an application filed years earlier.³ UP's proposal appears in detail in its proposed modification to § 1180.1(g) (Oversight). To conform to that rule, UP requests that the Board strike the last sentence of proposed § 1180.1(c)(1).

Proposed § 1180.1(c)(2): Potential harm.

UP believes the Board should broaden its rule defining public harms to include losses of efficiency and long-term damage to service, as well as losses of competition and transitional service problems.⁴ The rule should also require the Board to draw a conclusion about the net public benefits or harms of a merger.⁵ Accordingly, UP suggests that proposed § 1180.1(c)(2) be modified to read:

The Board recognizes that consolidation can impose costs as

² See Union Pacific's Opening Comments on Proposed Merger Rules, filed Nov. 17, 2000 ("UP's Opening Comments"), p. 18.

³ See *id.*, pp. 17-18.

⁴ See Union Pacific's Reply Comments on Proposed Merger Rules, filed Dec. 18, 2000 ("UP's Reply Comments"), p. 22.

⁵ See *id.*

well as benefits. It can reduce competition both directly and indirectly in particular markets, including product markets and geographic markets. It can reduce service quality for shippers located on connecting lines, impose costs on other carriers, and damage or destroy existing or potential joint ventures. Consolidation can also threaten essential services and the reliability of the rail network. In analyzing these impacts we must consider, but are not limited by, the policies embodied in the antitrust laws. In considering an application, the Board will determine whether the proposed transaction produces net public benefit or net public harm.

Proposed § 1180.1(c)(2)(i): Reduction of competition.

UP believes applicants should be required to demonstrate that major gateways affected by the merger will remain open, even if those gateways are wholly within another country.⁶ Accordingly, UP proposes that the Board modify the last sentence of proposed § 1180.1(c)(2)(i) as follows:

Applicants shall also explain how they would preserve competitive options such as those involving the use of major existing gateways and build-outs or build-ins, even if those locations are in a foreign country. []

In its Opening Comments to the Board's Advance Notice of Proposed Rulemaking ("ANPR"), UP proposed a specific mechanism for preserving major gateways and rate challenge options.⁷ UP proposes that the Board modify its proposed rule to add the following new provisions:

1180.1(c)(3): Preservation of major gateways and rate

⁶ See UP's Reply Comments, p. 25.

⁷ See Union Pacific's Comments and Initial Proposals, filed May 16, 2000, pp. 12-13. UP amended its proposal in its Reply Comments to the ANPR, Union Pacific's Reply Comments filed June 5, 2000, p. 34 n.24.

challenge options.

(a) A Primary Applicant in a *major* transaction approved by the Board (a "Participating Carrier") shall, upon request of an affected shipper, establish a rate for transportation (a "Segment Rate") applicable to traffic as to which no Participating Carrier served both the origin and destination of the traffic prior to consummation of the transaction (the "Subject Traffic"), between:

(1) any Exclusively Served Shipper Facility, which means any shipper facility (i) other than an automotive distribution ramp, intermodal facility, or transload facility (ii) that is located at any point on the carrier's system served exclusively by that carrier and no other rail carrier (either directly or via reciprocal switching, joint facility or other service arrangement) (iii) where traffic originated or terminated during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction; and

(2) the Pre-Transaction Gateway, which means the point of interchange, if one exists, that during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction, was (i) an actual interchange between the Participating Carrier and two or more other rail carriers, one of which was another Class I carrier participating in the transaction as a Primary Applicant, (ii) the interchange point most frequently used to move the Subject Traffic (or comparable traffic if the rate would apply to new traffic) between the Exclusively Served Shipper Facility and the origin or destination of the traffic, and (iii) used by at least 100 cars of traffic originating or terminating at the Exclusively Served Shipper Facility.

(b) The shipper at whose request a Segment Rate is established pursuant to this rule shall be entitled to combine the Segment Rate with a rate or rates offered by a carrier other than the Participating Carrier for movement between the Pre-Transaction Gateway and the origin or destination of the Subject Traffic.

(c) The shipper at whose request a Segment Rate is established pursuant to this rule shall be entitled to challenge

the Segment Rate as unreasonably high to the same extent and under the same standards as applicable to rate reasonableness challenges under 49 U.S.C. §§ 10701 and 10707. In determining whether the Participating Carrier is “market dominant,” the Board will examine whether there is an absence of effective competition on the entire origin-to-destination route, rather than on the segment between the Exclusively Served Shipper Facility and the Pre-Transaction Gateway.

(d) A shipper facility served exclusively by a Class III rail carrier that is incapable of interchanging traffic with any carrier other than the Participating Carrier, or that is obligated by contract to interchange the majority of its traffic with the Participating Carrier, shall be treated as a facility exclusively served by the Participating Carrier for purposes of this rule. If the Participating Carrier lacks authority to establish a Segment Rate between the Exclusively Served Shipper Facility and the Pre-Transaction Gateway, it shall instead establish a Segment Rate between the point of interchange with the Class III carrier and the Pre-Transaction Gateway.

(e) The obligation to establish a Segment Rate shall also apply to any rail carrier (a “Trackage Rights Carrier”) that receives trackage rights or other access to the lines of a Participating Carrier as a result of a settlement agreement with the Primary Applicants or conditions imposed on the Primary Applicants by the Board. The Trackage Rights Carrier shall be obligated to establish a Segment Rate pursuant to subparts (a)-(d) above only (1) for traffic capable of being handled using the rights or other access granted to the Trackage Rights Carrier and (2) between Exclusively Served Shipper Facilities located on the Trackage Rights Carrier’s system as it existed prior to the transaction and the applicable Pre-Transaction Gateway, if any, where such traffic was interchanged, during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction, with the Participating Carrier over whose lines access was granted.

(f) If there is no Pre-Transaction Gateway as defined in section (a)(1) because the interchange point between Participating Carriers used most frequently was not served by another carrier capable of participating in the traffic on an interline basis, then the Pre-Transaction Gateway shall be the reasonably proximate alternative interchange point

between the Participating Carrier and a carrier not participating in the transaction as a Primary Applicant (an “Alternate Gateway”) that, during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction, was (i) the Alternate Gateway used most frequently to handle the Subject Traffic, and (ii) used by at least 100 cars of traffic originating or terminating at the Exclusively-Served Shipper Facility.

Finally, UP asks the Board to clarify that the Board will evaluate all 3-to-2 situations on a case-by-case basis⁸ to avoid misinterpretation of the new rules. UP proposes the following change to proposed § 1180.1(c)(2)(i):

Intramodal competition may be reduced when two carriers serving the same origins and destinations merge.

Proposed § 1180.1(c)(2)(ii): Harm to essential services.

UP believes that the concept of “essential services” should apply only to freight service. While passenger service can be essential, the essential service analysis is inappropriate for passenger service; it could undermine contractual relationships and the long-term viability of freight service.⁹ UP also believes the Board should not use the “essential services” label to provide unwarranted special protection for Class II regional carriers.¹⁰ UP suggests that the Board modify the proposed § 1180.1(c)(2)(ii) to read:

The Board must ensure that essential freight [] services are preserved. An existing service is essential if there is sufficient public need for the service and adequate alternative transportation is not available. The Board’s focus is on the ability

⁸ See UP’s Opening Comments, p. 14.

⁹ See UP’s Reply Comments, p. 31.

¹⁰ See *id.*, pp. 30-32.

of the nation's transportation infrastructure to continue to provide and support essential services. Mergers should strengthen, not undermine, the ability of the rail network to advance the nation's economic growth and competitiveness, both domestically and internationally. The Board will consider whether projected shifts in traffic patterns could undermine the ability of the various network links (including [] Class III rail carriers and ports) to sustain essential services.

Proposed § 1180.1(c)(2)(iii): Transitional service problems.

No changes. UP's proposals regarding service assurance plans appear in its suggested modifications to proposed § 1180.10.

Proposed § 1180.1(c)(2)(iv): Enhanced competition.

As stated above, UP believes that the Board is incorrect in assuming that it cannot remedy all significant competitive harms. Accordingly, UP proposes that section (iv) be withdrawn.

Proposed § 1180.1(d): Conditions.

The Board should clarify its proposed rule to make clear that any party, not merely the applicants, may propose conditions to preserve competition.¹¹ UP also believes that the special consideration accorded to non-Class I carriers should be reserved for Class III short lines.¹² Further, as stated above, UP believes applicants should not be required to enhance competition in ways that do not address effects of the merger and that competitive harms and transitional service problems can be remedied directly. Accordingly,

¹¹ See UP's Reply Comments, p. 13 n.17.

¹² See *id.*, p. 37.

UP suggests that proposed § 1180.1(d) be modified to read:

The Board has broad authority under 49 U.S.C. § 11324(c) to impose conditions on consolidations, including divestiture of parallel tracks or requiring the granting of trackage rights and access to other facilities. The Board will condition the approval of Class I combinations to mitigate or offset harm to the public interest, and will carefully consider conditions proposed by applicants or other interested parties in this regard. The Board will impose conditions that are operationally feasible and produce net public benefits so as not to undermine or defeat beneficial transactions by creating unreasonable operating, financial, or other problems for the combined carrier. Conditions are generally not appropriate to compensate parties who may be disadvantaged by increased competition. []

Proposed § 1180.1(e): Labor protection.

UP joins in the comments of the National Railway Labor Conference.

Proposed § 1180.1(f): Environment and safety.

UP agrees with AAR that applicants should not be required to negotiate with neighborhood communities. Accordingly, the phrase “groups of neighborhood communities” should be stricken. UP believes the Board’s desire for evidence on blocked grade crossings will generate no useful information.¹³ Accordingly, UP requests that the Board modify proposed § 1180.1(f)(2) by removing the final sentence.

Proposed § 1180.1(g): Oversight.

UP supports a five-year formal oversight condition. UP is concerned that the proposed rule requires the merged carrier to adhere too rigidly to proposals applicants will

¹³ See UP’s Opening Comments, p. 8.

have made up to six or seven years earlier. Economic and competitive conditions change too rapidly to impose such a straitjacket. The merged carrier should be required to show that it is using reasonable efforts to achieve the benefits of the merger.¹⁴ Also, UP believes that the rule leaves the Board with too much open-ended flexibility to impose additional post-merger conditions on a merged carrier. All of these concerns cause us to recommend the revised language set forth below.

UP proposes that the Board remove the phrase “or impose new ones” in the second sentence of proposed § 1180.1(g) and delete the last sentence. We also recommend two additional sentences:

The Board recognizes, however, that applicants require the flexibility to adapt to changing circumstances and that it is inevitable that their merger will not be implemented in precisely the manner anticipated in the application. Applicants therefore satisfy their obligation by demonstrating that they acted reasonably to achieve merger benefits in light of changing circumstances.

UP also takes this final opportunity to clarify UP’s position concerning the Board’s authority to impose new conditions on consummated transactions. Several commentors question or seem confused about UP’s positions on these complex issues.¹⁵ These commentors assert that the Board has unrestricted and perpetual authority to change merger conditions, arguing that “Congress has specifically given the STB the authority to change the terms of its approval of a transaction even following implementation.” See, e.g.,

¹⁴ See id., p. 15.

Reply Comments of SCRRA, p. 4. They rely on 49 U.S.C. § 722(c), which allows the Board upon a showing of “material error, new evidence, or substantially changed circumstances” to reopen a proceeding; grant rehearing, reargument, or reconsideration of an action of the Board; or change an action of the Board.

In considering the issues, the Board should clearly distinguish three separate situations.

1. Preserving the effectiveness of conditions.

The parties appear to agree that the Board can and should take actions necessary to ensure that its conditions remain effective. Thus, if the Board imposes a condition to preserve competition but the condition is ineffective, the Board should modify that condition or impose another to achieve the same objective. Similarly, if a subsequent merger would undermine the effectiveness of a condition, as would have been the case in the UP-MKT merger, it is appropriate for the Board to impose a condition on the subsequent merger to preserve the objective of the original condition.¹⁶

2. Changing the rules retroactively.

The Board cannot apply new standards or rules to past mergers. Under the Administrative Procedure Act (“APA”) and Supreme Court precedent, the Board cannot give retroactive effect to new merger rules. Any “rule” formulated in this proceeding, for

(... footnote cont'd)

¹⁵ See Reply Comments of New York City Econ. Dev. Corp., pp. 3-5; State of Md. Dep’t of Transp., pp. 4-5; Southern Cal. Reg’l Rail Auth., (“SCRRA”) pp. 4-5.

¹⁶ See UP’s Reply Comments, p. 6; KCS Opening Comments, pp. 17 n.6, 28-29.

example, can only have future effect. See 5 U.S.C. § 551(4). The Supreme Court made this clear in Bowen v. Georgetown University Hospital, 488 U.S. 204, 208 (1988), when it stated “a statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms.” As the Supreme Court reconfirmed in Hughes Aircraft Co. v. United States ex rel. Shumer, 520 U.S. 939, 946 (1997), the presumption against retroactivity is “time-honored . . . unless Congress has clearly manifested its intent to the contrary.”

Retroactive application of a rule is an application that “would impair the rights a party possessed when he acted, increase a party’s liability for past conduct, or impose new duties with respect to transactions already complete.” Landgraf v. USI Film Prods., 511 U.S. 244, 280 (1994). See also Davey v. City of Omaha, 107 F.3d 587, 592-93 (8th Cir. 1997) (amendment to Title VII not permitted to apply retroactively because it “attaches new consequences to prior conduct and significantly alters the legal terrain”). Imposing the Board’s new merger rules on consummated transactions approved under different rules and policies would constitute retroactive application of those rules as it would attach new and unforeseen duties on previously consummated transactions. The Board therefore appropriately announced that the new rules it is developing will apply only to future mergers. NOPR, p. 9.

A few parties argue that Congress gave the Board authority to promulgate retroactive rules and regulations in 49 U.S.C. § 722. Section 722 authorizes the Board to reopen a proceeding based on new evidence, mistake, or substantially changed circumstances. Those commenters argue that the power to “reopen” inherently carries with it the

authority “to change the terms of its approval of a transaction even following implementation” and to “add a new condition.” See, e.g., Reply Comments of New York City Econ. Dev. Corp., p. 4.

This is not so. The language of § 722 contains no “express” authorization to change rules after a decision. If the Board reopens a consummated merger based on new evidence, mistake or substantially changed conditions, it may do so only under the rules, policies, and precedents in place when the merger was approved. It can do so only to carry out the original decision. Applying new rules would impair the rights the railroads possessed when they acted, increase a railroad’s liability for past conduct, and impose new duties with respect to transactions already complete. In short, § 722 does not provide the express authority required by the APA and Bowen to authorize retroactive application of these new merger rules to mergers consummated before the rules are promulgated.

Congress did not intend to give the Board permanent jurisdiction over merged carriers to impose whatever conditions the Board might deem appropriate at some later point in time. Instead, the statute authorizes the Board to impose conditions only on its approval of the merger. See 49 U.S.C. § 11324(c) (Board may impose conditions “governing the transaction” when it approves and authorizes the transaction). The breadth of the Board’s authority to impose conditions on mergers – which greatly exceeds the Board’s authority to impose the same forms of relief, such as trackage rights, outside a merger – derives from the merging carrier’s acquiescence in the conditions imposed by the Board. Before consummating the transaction, applicants can choose whether to accept the Board’s conditions as the price of obtaining the Board’s approval. See, e.g., Illinois Central R.R. v. United States, 263 F. Supp. 421, 435 (N.D. Ill. 1966) (three-judge panel), aff’d, 385

U.S. 457 (1967) (per curiam). That acquiescence – and accordingly the Board’s authority – disappears if additional conditions are imposed later based on new standards. The ICC has long recognized this limit on its authority:

If the carriers do not accept the conditions imposed by the Commission, they need not consummate the transaction. Now that the . . . transactions have already been consummated, the imposition of a trackage rights condition would lack the element of agreement.

Guilford Transp. Indus., Inc. – Control – Boston & Maine Corp. (“Guilford”), 5 I.C.C.2d 202, 206 (1988) (footnotes omitted); see also Boston & Maine Corp. Trackage Rights Over Conrail, 360 I.C.C. 239, 241 (1979).

Accordingly, once the Board grants conditional approval of a merger application, its authority is limited to overseeing, modifying, and if necessary replacing the conditions the applicants accepted. For example, UP consummated its acquisition of SP on the express understanding that the conditions imposed by the Board were limited to those specifically enumerated in the Board’s decision,¹⁷ including the Board’s retention of “oversight jurisdiction” for five years to “impos[e] additional remedial conditions *if, and to the extent*, we determined that *the conditions already imposed* were not effectively addressing competitive harms caused by the merger.” Finance Docket No. 32760 (Sub-No. 21), UP/SP

¹⁷ The Board’s Order in UP/SP expressly provided that all conditions not “specifically approved in this decision are denied.” UP/SP, 1 S.T.B. 233, 554 (1996) (ordering paragraph ¶ 63).

General Oversight, Decision No. 16, served Dec. 15, 2000, p. 13 (emphasis added).¹⁸ As a result, as the Board recently held in the UP/SP General Oversight proceeding, any “suggestion to apply retroactively our newly proposed merger guidelines to mergers that have already received our approval is clearly inappropriate.”¹⁹

Wholly apart from the issue of the legality of retroactively imposing conditions on past mergers based on the Board’s new rules, doing so would also be fundamentally unfair. As the ICC held: “The unfairness that would result from imposing a condition of which the consolidating carriers had no advance knowledge at the time of consummation is obvious.” Guilford, 5 I.C.C. 2d at 206.²⁰

3. "Springing conditions" on mergers approved under the new rules.

In a *future* merger case, if the Board expressly retained jurisdiction to impose additional conditions, the Board may have greater authority to impose additional conditions on a consummated merger, which we refer to as “springing” conditions.

UP respectfully suggests, however, that the Board’s proposal to “retain

¹⁸ See also id. (noting that Board imposed five-year oversight condition, for sole purpose of “examin[ing] whether the conditions we imposed have effectively addressed the competitive issues they were intended to remedy”).

¹⁹ Id. at 12.

²⁰ See also ICC v. Southern Ry., 380 F. Supp. 386, 399 n.26 (M.D. Ga. 1974), aff’d in part & vacated in part on other grounds, 543 F.2d 534 (5th Cir. 1976) (interpreting scope of conditions imposed on merger, court noted that “sight should not be lost of the fact that the DT&I conditions were imposed in each of the orders essentially with the consent of the Defendants without detailed exploration of their precise effect on the Defendants’ operations. Under such circumstances, the Court must question the simple fairness of subjecting Defendants to obligations which certainly were not expressly considered at the

(continued ...)

jurisdiction to impose any additional conditions it determines are necessary to remedy or offset unforeseen adverse consequences of the underlying transaction” (see proposed § 1180.1(g)),²¹ would reserve too much discretion to adopt springing conditions. If the Board concludes that it must reserve jurisdiction to impose additional conditions, it should define in its approval decision the specific goals and objectives it is attempting to achieve, the specific circumstances that might warrant imposing additional conditions, and the types of conditions it might impose. The Board should then limit later conditions to those necessary to achieve the original goals and objectives. For example, if the merged carrier experiences a service failure, as UP did after the SP merger, Board action to address the failure would be appropriate. But the Board should not attempt to reserve unrestricted power to address any “unforeseen” consequence that might arise.

UP offers this suggestion for several reasons. First, we doubt the Board’s legal power to impose unrestricted springing conditions. Second, even if authorized, attempting to retain broad freedom to impose springing conditions would be unwise as a policy matter. Applicants would never close a merger under such a cloud of regulatory uncertainty, even if the transaction promised clear public and private benefits. They would not be able to evaluate the costs and benefits of a proposed merger because they would not know what conditions the Board would adopt in the future. Third, as time passes it would

(... footnote cont'd)

times the conditions were imposed and which are, at best, not readily apparent from the language of the conditions themselves.”)

be increasingly difficult to unscramble the effects of a transaction from other changes in economic and competitive conditions, which the Board must be able to do in order for any condition to be connected to the merger and thus fall within the scope of the Board's statutory authority to impose "conditions governing the transaction." 49 U.S.C. § 11324(c). Finally, the Board has a long-established policy favoring finality in its review of merger proceedings. See, e.g., Seaboard Coast Line R.R. – Investigation of Control & Modification of Traffic Conditions, 360 I.C.C. 582, 606 (1979) ("It is not appropriate to reopen a 15-year-old merger proceeding to reconsider issues which were fully litigated. Such proceedings must have finality."). This policy avoids excessive monitoring and market intervention by the Board and confines most litigation over a merger to a single proceeding.

For these reasons, the Board should not attempt to retain indefinite jurisdiction over the proposed transaction to impose new duties on the applicants after the railroads have obtained the Board's approval. The Board should further avoid imposing springing conditions on a proposed transaction unless the Board places the parties on notice that reasonably specific events would trigger well-defined conditions to ensure that the merger remains in the public interest.

Proposed § 1180.1(h): Service assurance and operational monitoring

Throughout this proceeding, UP has joined the chorus of support for detailed service planning and monitoring. Unlike other railroads, however, UP favors a base level

(... footnote cont'd)

²¹ See also proposed § 1180.6(b)(12) (contemplating that Board would impose "new conditions ... should [it] approve additional future rail mergers").

of protection from service failures. To provide that protection, applicants must maintain data showing whether service has improved or deteriorated in comparison to pre-merger service.²² Accordingly, UP requests that the Board add the following language to its proposed § 1180.1(h):

(4) For the base year, applicants in a *major* transaction must prepare and maintain a database from which it is possible to obtain pre-consolidation (i) transit times and variability of transit times for all shipments; (ii) cycle times and variability of cycle times for all applicable shipments; and (iii) supply of empty cars (collectively, “Service Measurements”). If the consolidation is approved, the combined carrier must maintain this database for five years after the effective date of the Board’s decision approving the consolidation, and provide Service Measurements to affected shippers or Class III rail carriers that have a legitimate need for the information in order to demonstrate service deterioration.

(5) The following provisions apply for a period of five years after the effective date of the Board’s decision approving the consolidation:

(i) If a shipper (not a third-party beneficiary) or Class III rail carrier that has shipped more than 100 cars over 12 months in a corridor can show that a Service Measurement for its traffic has deteriorated by an average of more than 50 percent from pre-consolidation levels for more than 60 consecutive days, it may give the consolidated carrier written notice asking the railroad to cure service within 60 days from the date of receipt of the notice and to provide historical and current Service Measurements for the affected traffic.

(ii) If the carrier is unable to restore service to the 50 percent level by the end of the 60-day cure period, the shipper or Class III rail carrier may file a service

²² See UP’s Opening Comments, p. 9.

complaint with the Board seeking a remedy for inadequate service. This remedy supplements any other rights and remedies the shipper may have under contracts or at law. To file a service complaint, the shipper or Class III rail carrier must show that the carrier's service, as measured by any of the Service Measurements, deteriorated by an average of more than 50 percent from the base period for 120 or more consecutive days (through the cure period), that it cooperated with the carrier in efforts to restore service, and that it has incurred increased transportation costs as a result of the deteriorated service. Unless the carrier can establish in a reply to be filed within ten days after receipt of the service complaint either (x) that the service decline is attributable to factors other than implementation of the consolidation or (y) that the complaining party did not reasonably cooperate with remediation efforts, the Board may grant either of the following remedies within 30 days after the complaint is filed:

(A) temporary access by reciprocal switching or trackage rights (including, if necessary, temporary trackage rights over other carriers) to the complainant's facility, if the Board concludes that access will result in improved service to the shipper and will not adversely affect service to other shippers or further degrade the operations of the consolidated carrier; or

(B) reimbursement of incremental transportation costs that could not reasonably be mitigated and that were incurred by the complainant or, if complainant is a Class III rail carrier, by shippers located on that carrier.

(iii) Pursuant to 49 U.S.C. § 11123, the Board will reconsider the need for the service remedy after 30 days, and the service remedy will automatically expire, if not previously terminated, after 270 days. The consolidated railroad may at any time petition for termination of a service remedy on the ground that service has been restored to the 50 percent level.

(iv) If the Board grants temporary access and the railroads cannot agree on compensation, the Board will apply compensation standards under 49 U.S.C. §§ 11102 and 11123.

(v) The entity obtaining access must be a rail carrier with operating authority from the Board, and the Board must determine that such carrier can operate safely to address the service problem.

(vi) Remedies are available only to shippers lacking existing rail alternatives; provided, however, that the complainant may seek compensation if it can show that the other serving carriers are disabled by the merger-related service problem.

(vii) If necessary to effectuate the temporary access remedy, the Board may temporarily suspend a shipper's contractual duty to ship specified volumes of traffic under rail service contracts with the consolidated carrier. The suspension would apply only for the time period necessary to alleviate the service problem.

Only one party, the National Grain and Feed Association ("NGFA"), offers specific comments on UP's proposed remedy. NGFA raises an important threshold issue. It fears that UP's proposal is a "trap," intended to interpose a limited remedy that would supercede all other remedies under contracts or at law. NGFA Reply Comments, pp. 6-8. UP harbors no such intent. Accordingly, we have added the second sentence in clause (ii) above to make clear that all other rights would survive.

NGFA also argues, incorrectly, that UP's remedy would be withdrawn if service recovers for even "a day." *Id.*, p. 7. This is a misreading of UP's proposal. UP proposes to measure service on the basis of averages over a 60-day period, not on the basis of a single day. Indeed, it is impossible to measure transit times and cycle times on a one-day basis.

UP supports the Board in encouraging service agreements. UP believes, however, that service agreements should be disclosed and filed with the Board if the non-applicant party submits comments on the merger or if the agreement affects merger implementation.²³ The contracting parties should be permitted to keep commercially sensitive information in their agreements confidential. Accordingly, UP requests that the Board add the following section to its proposed § 1180.1(h):

(6)(i) We encourage applicants to engage in good faith negotiations for service agreements with shippers and connecting parties. Any service agreements entered into as a result of those negotiations must be disclosed and filed with the Board if the non-applicant party submits comments on the merger or if the agreement affects implementation of the merger. Commercially sensitive terms and financial remedies for service failures may be treated as confidential and subject to a protective order.

(ii) Parties who reach service agreements with merger applicants will be limited to the service failure remedies contained in those agreements.

(iii) Parties who do not reach service agreements with merger applicants may avail themselves of the service failure remedy contained in 1180.1(h)(5) above and any other remedies under contract or law.

Proposed § 1180.1(i): Cumulative impacts and crossover effects.

The Board correctly concluded that any further Class 1 merger, “if approved, would likely result in the creation of two North American transcontinental railroads” and “have a significant effect on the structure of the entire industry.” NOPR, pp. 8, 21; see also ANPR, p. 4. The record before the Board is replete with evidence supporting this conclu-

²³ See UP’s Reply Comments, pp. 10-12.

sion. See, e.g., Ex Parte No. 582, Public Views on Major Rail Consolidations, Decision served Mar. 17, 2000, p. 3 (concluding that there is a “substantial possibility that, absence decisive action on our part, in the very near future, we will likely be left with the prospect of only two large railroads serving North America”). The Board proposed several interrelated rules that would delineate the manner in which future applicants would be required to address, and the Board would consider, downstream effects. See proposed §§ 1180.1(i) and 1180.6(b)(12).

The basic proposition that the Board should consider downstream effects continues to draw virtually unanimous support. Indeed, it appears that most commenters believed that this proposition was so well established that they did not discuss the Board’s downstream rules after the first round of comments. Only CN opposes any inquiry into downstream effects.

Many commenters, including UP, believe that the Board’s proposed rules – both § 1180.1(i) and 1180.6(b)(12) – place undue emphasis on speculative predictions about specific future merger applications.²⁴ As UP explained, the Board’s approach not only calls for too much speculation, it risks allowing applicants to sidestep the single most important issue that will face the Board when the next major merger is proposed: whether the “end game” that would likely follow approval of the next major merger and result in two North American rail systems is consistent with the public interest. UP also favors consolidating contemporaneous applications. Accordingly, UP proposes that the Board replace the last

²⁴ See UP’s Opening Comments, p. 4; UP’s Reply Comments, pp. 8-9.

three sentences of proposed § 1180.1(i) with the following provisions:

(1) Applicants proposing a major transaction must evaluate the effects on competition and the public interest of combining all Class I railroads in the United States and Canada into two North American Class I railroads. Applicants need not identify specific combinations, but should evaluate the implications of an industry structure consisting of two major railroads.²⁵

(2) The Board may, on its own motion or on request of any interested party, consolidate for hearing and decision any application proposing a major transaction filed before the date set for filing of inconsistent applications in another pending proceeding arising out of another application proposing a major transaction.

CN objects to UP's proposal.²⁶ CN argues that considering the public interest implications of a two-system rail network would be a waste of time. CN contends that such an evaluation could not be performed "to a sufficient degree that it could directly affect a Board decision in a pending merger." CN Reply Comments, p. 12. This is nonsense. The Board would have ample authority to deny or condition the next major merger proposal if it concluded that the transaction would lead to structural changes that are inconsistent with the public interest.²⁷

²⁵ See UP's Reply Comments, p. 9.

²⁶ Because UP's proposal would eliminate the obligation to address specific downstream transactions – unless such transactions are actually proposed or readily anticipated – most of CN's criticisms are inapplicable.

²⁷ Other agencies, including antitrust enforcers and courts, similarly evaluate proposed transactions in the context of the "downstream" effects on industry structure. See, e.g., FTC v. Bass Brothers Enters., Inc., 1984-1 Trade Cas. ¶ 66,041, at 68,621 (N.D. Ohio 1984) ("A tendency toward concentration is a significant factor in judging the legality of an acquisition. If the trend towards concentration in the United States carbon back industry is

(continued ...)

CN alternatively suggests that if the Board gives any consideration to the implications of a two-system North American rail network, it should employ a “seminar” or “workshop,” not “actual merger proceedings that have legal and economic consequences.” CN Reply Comments, pp. 13-15. The goal of this proposal is obviously to allow CN to pursue mergers that launch the “end game” without considering the consequences.²⁸ The next major merger case may present the only opportunity for the Board to stop a further round of consolidation that might be contrary to the public interest. Moreover, the Board would be far better equipped to address downstream effects in the context of a particular merger proposal, because parties will be more highly motivated to develop and address the issues in depth.

The difficulty of performing effective downstream analysis does not mean that the Board should disregard downstream effects altogether as CN recommends. See CN

(... footnote cont'd)

not halted, competition in the ... industry may be substantially lessened.”); see also Remarks of Robert Pitofsky, FTC Chairman, Feb. 17, 2000 (responsibility of enforcement officials is “not just to examine the merits of a particular transaction, but to take into account where the industry, as a result of similar transaction, might be going”); Testimony of William J. Baer, Director of FTC Bureau of Competition, before the House Subcommittee on Energy and Power of the Committee on Energy, Mar. 10, 1999 (“Commission approaches its antitrust mission by examining the areas in which merging companies compete, looking at the existing state of competition in the marketplace and the likely changes in that marketplace in the future. ... [W]e look at the trends in the industry, including trends toward further concentration.”).

²⁸ CN extols the recent FTC workshop on competitive issues raised by B2B e-commerce ventures as a model for the Board’s consideration of the downstream effects of future mergers. However, the FTC staff report on that workshop emphasized that the workshop merely laid a foundation for more rigorous consideration of the issues in actual factual settings presented by particular transactions. See FTC Staff Report, “Entering the
(continued ...)

Reply Comments, pp. 6-17. Nor should consideration of downstream effects be limited to the effects of mergers “actually proposed in response to a particular transaction.” NS Reply Comments, p. 44. To the contrary, the Board should strengthen its rule by focusing on the public interest consequences of restructuring the North American rail system into a duopoly. The Board must consider this question when the next major merger is proposed, because it would be too late to preserve the current structure once that merger is consummated. The Class I railroads whose merger proposal would spawn this transformation should open the debate with an in-depth analysis of the public interest implications.²⁹

Proposed § 1180.1(j): Inclusion of other carriers.

No changes.

Proposed § 1180.1(k): Transnational issues.

UP believes the Board should make clear that it will impose conditions to remedy potential adverse consequences of transactions involving foreign owners or operations, even where jurisdictional limits on the Board’s authority may preclude the Board

(... footnote cont'd)

21st Century: Competition Policy in the World of B2B Electronic Marketplaces,” Oct. 2000, Executive Summary, p. 2 & n.2.

²⁹ This obligation should apply to all major mergers, any one of which would likely trigger a further round of consolidation resulting in two continent-wide systems and not just “transcontinental mergers.” See, e.g., Ex Parte No. 582, Public Views on Major Rail Consolidations, Decision served Mar. 17, 2000, p. 4 (concluding that proposed BNSF/CN transaction would trigger final round of consolidation). Of course, any prospective applicant would have the right to seek a waiver of this requirement upon a persuasive showing that its proposed transaction would clearly not implicate these downstream concerns. Several commenters expressed support for UP’s proposal either expressly, see IMPACT Reply Comments at 36-37, or by supporting consideration of a “two-railroad industry in North America,” see, e.g., Edison Electric Inst. Reply Comments at 17.

from granting relief directly.³⁰ Accordingly, UP has proposed that the Board add a section to proposed 1180.1(k) as follows:

(3) In *major* transactions involving carriers with foreign operations, the Board may impose conditions to ameliorate potential adverse effects arising outside the United States. The Board may, for example, as a condition to approving the transaction, require applicants to enter into legally enforceable private agreements that would remedy potential harms.

Proposed § 1180.1(l): National defense.

No changes.

Proposed § 1180.1(m): Public participation.

No changes.

TECHNICAL AND INFORMATIONAL REVISIONS

Current § 1180.2: Types of transactions.

UP proposes modifying subsection (a) of § 1180.2 (Types of transactions) to avoid any confusion that may arise from the Board's recent notice of rulemaking for consolidated financial reporting.³¹ UP suggests that § 1180.2(a) be amended to read:

A *major* transaction is a control or merger involving two or more Class I railroads. For purposes of this section, commonly controlled railroads will be considered a Class I railroad if the affiliated, contiguous carriers earn revenues in excess of \$250 million and offer integrated service to shippers.

Proposed § 1180.6(b)(10): Conditions to mitigate and offset merger harms.

As stated above, UP believes the Board should not require applicants to

³⁰ See Union Pacific's Comments and Initial Proposals, filed May 16, 2000, p. 21.

³¹ See UP's Reply Comments, p. 36.

propose conditions that enhance competition, but rather, applicants should be required to preserve existing competition. Accordingly, UP proposes that the Board strike the last sentence of proposed § 1180.6(b)(10). UP proposes the same changes to proposed § 1180.6(b)(10)(i) that we proposed for § 1180.1(c)(2)(i):³²

(i) Applicants must explain how they will preserve competitive options for shippers and for Class [] III rail carriers. At a minimum, applicants must explain how they would preserve competitive options such as those involving the use of major existing gateways and build-outs or build-ins, even if those locations are in a foreign country. []

Proposed § 1180.6(b)(11): Calculating public benefits.

UP encourages the Board to modify proposed § 1180.6(b)(11) to require applicants to explain why the benefits they propose are merger-specific and cannot be achieved through alliances, joint ventures, or other inter-railroad arrangements.³³ This change is necessary to bring § 1180.6(b)(11) into conformity with the Board's general policy statement, which recognizes that public benefits must be merger-specific, see proposed § 1180.1(a) (stating that the Board will look with disfavor on applications that fail to show "substantial and demonstrable public benefits to the transaction that cannot otherwise be achieved") (emphasis added), and with the Board's proposed public interest test, which requires the Board to "consider whether the benefits claimed by applicants could

³² See page 5 above.

³³ See UP's Reply Comments, pp. 19-21.

be realized by means other than the proposed consolidation,” proposed § 1180.1(c).³⁴

Finally, UP believes that requiring applicants to propose measures to remedy unrealized or delayed public benefits would be too speculative and would compel the merged carrier to pursue plans that no longer make sense under changed conditions. For this reason, and also to bring this proposed rule into conformity with proposed §§ 1180.1(c) and 1180.1(g), UP requests that proposed § 1180.6(b)(11) be modified to read:

Applicants must enumerate and, where possible, quantify the net public benefits their merger will generate (if approved). In making this estimate, applicants should identify the benefits arising from service improvements, enhanced competition, cost savings, and other merger-related public interest benefits, and should explain why the benefits they propose cannot reasonably be achieved through alliances, joint ventures, or other inter-railroad arrangements. Applicants must also identify, discuss, and, where possible, quantify the likely negative effects approval will entail, such as losses of competition, potential for service disruption, reduced service quality for shippers on connecting lines, cost increases on other railroads, damage to existing or potential joint ventures, and other merger-related harms. []

Proposed § 1180.6(b)(12): Downstream merger applications.

UP is concerned that the Board’s proposed language requires applicants to guess at future transactions and may lead applicants to evade critical public policy issues.³⁵

UP also supports consolidation of contemporaneous applications. UP therefore requests that the Board replace its proposed § 1180.6(b)(12) with the following:

³⁴ See *id.*, p. 21.

³⁵ See pages 23-26, above; see also UP’s Opening Comments, pp. 4-5; UP’s Reply Comments, p. 8.

- (i) Applicants proposing a major transaction must evaluate the effects on competition and the public interest of combining all Class I railroads in the United States and Canada into two North American Class I railroads. Applicants need not identify specific combinations, but should evaluate the implications of an industry structure consisting of two major railroads.³⁶
- (ii) The Board may, on its own motion or on request of any interested party, consolidate for hearing and decision any application proposing a major transaction filed before the date set for filing of inconsistent applications in another pending proceeding arising out of another application proposing a major transaction.

Proposed § 1180.6(b)(13): Purpose of the proposed transaction.

No changes.

Proposed § 1180.7: Market analyses.

As stated above, UP believes that passenger and commuter services should not be characterized as essential services and that special protection should not be afforded to Class II regional carriers. UP also believes that the proposed rules place undue emphasis on market shares and require information on modal shares and rail line characteristics that will not be available to applicants. Accordingly, UP suggests that the Board modify proposed § 1180.7(b) as follows:

- In the first sentence of proposed § 1180.7(b), add “freight” between “essential” and “services”; delete the second parenthetical phrase; and delete “Class II and”.
- In clause (2), retain only the last sentence.

³⁶ See UP’s Reply Comments, p. 9.

- Delete clause (3).
- In clause (6), remove “Class II and”.

Proposed § 1180.8(a): Operational data.

No changes.

Proposed § 1180.10: Service assurance plans.

UP agrees that applicants should explain to the shipping community how they will implement their proposed transaction and how they plan to avoid transitional service problems.³⁷ However, the concept of fulfilling passenger service performance agreements, included in proposed § 1180.1(b), is not meaningful. Many such agreements contain sliding scales of compensation based on multiple levels of performance. UP recommends that the Board revise the language of this provision to require applicants to “describe definitively any effects of their proposed merger on those services.”

Proposed § 1180.11: Additional information needs for transnational mergers.

No changes.

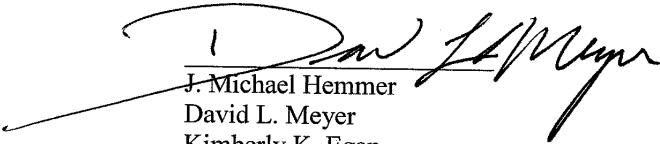
CONCLUSION

For the reasons stated herein and in UP’s prior comments in this proceeding, UP urges the Board to revise its proposed rules in the manner proposed by UP and to resist inconsistent proposals for revisions proposed by other commenters.

³⁷ See UP’s Initial Comments, pp. 6-8.

Respectfully submitted,

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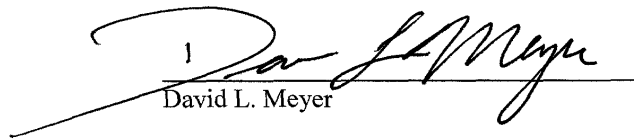
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January 11, 2001

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 11th day of January, 2001, a copy of the foregoing "Union Pacific's Closing Comments" was served by regular mail, postage prepaid, or a more expeditious manner of delivery on all parties and non-parties of record to this proceeding.

1
David L. Meyer